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Wednesday, December 15, 2004

Inter-American Dialogue
LATIN AMERICA ADVISOR

Featured Q&A *With Our Board of Advisors*

Q Last week, a loose majority alliance in Ecuador's Congress, temporarily loyal to President Lucio Gutierrez, voted to dismiss almost all of the 31 justices on the Supreme Court, which Gutierrez accused of being controlled by the opposition. What is the significance of the Supreme Court purge in Ecuador? Does it strengthen or weaken the country's fragile political institutions? How will outside actors (the United States, OAS, IMF) react?

A **Guest Comment: Andres Mejia-Acosta:** "The current constitutional crisis triggered by the purging of the courts is a dramatic deterioration of the already weak democratic institutions in Ecuador. For the past two decades, the appointment of Supreme Court justices has been strongly driven and controlled by congressional realignments, resulting in a severe politicization of the judiciary. The current purge is perceived to be a government-led political maneuver to dismantle the alleged control of the courts by former President Leon Febres Cordero—the leader of the coastal-based conservative PSC party—while facilitating the return from exile of former president Bucaram—ousted in 1997 and accused of government embezzlement. Besides violating the constitutional principle of judiciary independence, the current court purge adds to the recent sacking of members of the Constitutional Court and Electoral Tribunals by the same pro-government majority. The increasing control of the government alliance over oversight mechanisms casts serious doubts over the transparency of democratic institutions. International inaction regarding this political crisis would endorse political bickering in Ecuador. A more conciliatory diplomatic action from outside actors—rather than imposing drastic external sanctions—could better contribute to balancing the correlation of political forces and prevent further escalation of conflict in the already unpopular government of Lucio Gutierrez."

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PHOTO OF THE DAY

Colombian President Alvaro Uribe on Tuesday decreed capital controls, requiring foreign capital to stay in the country for a minimum of one year. See related news on page 2.

Source: Casa de Narino.

Inside This Issue

NEWS BRIEFS

Foreign Creditors Forgive 61 Percent of Nicaraguan Debt

Foreign creditors have cancelled $3.836 billion, or 61 percent, of the Nicaraguan government's $6.925 billion in foreign debt, Central Bank President Mario Alonso said Tuesday. Debt cancelled by the Paris Club of creditor countries totaled $1.666 billion, while that of multilateral lenders, including the International Monetary Fund, World Bank, and Inter-American Development Bank, amounted to $1.218 billion. Nicaragua, the second-poorest country in the Western Hemisphere, is a beneficiary of the Heavily Indebted Poor Countries debt relief initiative.

Source: Reuters.

PC Penetration Seen Growing in Mexico

Forty percent of Mexicans will own a personal computer by the year 2010, according to a study released Tuesday by **Forrester Research**. Of the 16 emerging markets included in the study, Mexico is expected to experience the deepest penetration of personal computers, according to the repot. PC use in emerging markets is expected to grow from 75 million currently to 566 million by 2010, the report said.

Source: Reuters.

El Salvador's Taca Orders 14 More Airbus Planes

France's **Airbus** announced Tuesday that El Salvador-based airline **Taca** had signed a contract to buy 14 aircraft. The 14 passenger planes, as well as 12 others ordered previously, will be delivered between April 2005 and September 2009. Taca currently has a fleet of 32 Airbus planes serving the entire Western Hemisphere.

Source: Airbus press release.

Economic News

Colombian Senate Passes Watered-Down Pension Reform Bill

Colombia's Senate on Tuesday approved a watered-down pension reform bill, Reuters reported. In the fourth of eight votes needed to pass the bill, the Senate okayed cuts to pension payments starting in 2010, two years later than the original starting year of 2010 proposed by the government of President Alvaro Uribe. Analysts see reforms to Colombia's burdensome public pension system as key to the government's future fiscal health. The public pension system's operational deficit, which is expected to reach 4.6 percent of GDP this year, will have to be financed completely by the government starting in 2005 due to the exhaustion of the Social Security Institute's financial reserves, according to **J.P. Morgan Chase**. Following the bill's approval in the Senate yesterday, senators must reconcile their version of the bill with that passed by the lower house. Lawmakers have until next Thursday to draft a joint bill in order for the bill to be considered in another round of votes starting in March 2005. Carola Sandy, an analyst at **Credit Suisse First Boston**, in a research note published this morning expressed doubt that Uribe would be able to force a strong version of the pension reform bill through Congress. "This implies that transfers to the public social security system will continue increasing for several more years, which the government cannot offset with cuts elsewhere," Sandy said. As a result, the central government deficit should rise to 6.1 percent of GDP next year, up from 5.6 percent this year, Sandy said. In other Colombian economic news, the government on Tuesday implemented capital controls aimed at halting a strengthening of the peso currency that threatens to hurt exports. According to a decree issued by Uribe and posted on the president's Web site, foreign capital will be required to stay in Colombia for a minimum of one year. "We want to give a very clear signal that Colombia is ready to receive serious capital that comes to invest, to stay in the country," Uribe said. "But we cannot allow short-term speculative capital to come and hurt the exchange rate."

EU Official Urges Argentina to Negotiate Tarrifs with Utilities

A European Union official said Tuesday the Argentine government must renegotiate tariffs with European-owned utilities within the next few months or endanger political relations with the EU, Reuters reported. "Everybody is aware that this has be solved in the next few months. It's the indispensable time frame for ending these difficulties," Eneko Landaburu, the European Union's director general of external relations, was quoted as telling reporters. Argentina froze prices on public services and utilities to protect consumers from skyrocketing prices after devaluing its currency in 2001. Although the utilities' contracts were fixed in dollars, they are now paid in devalued Argentine pesos. The utilities, who say they are unable to meet their dollar debt payments, are pushing the government for higher tariffs. The companies say they cannot guarantee normal delivery of their services at current tariffs or make investments. European utility companies operating in Argentina include Spanish power company **Endesa**, Italy's **Telecom Italia SpA**, and Spain's **Telefonica**. Landaburu noted that negotiations are underway with some utilities, while talks with 13 other companies are scheduled for December and January. In other Argentina economic news, unnamed sources at the International Monetary Fund (IMF) told Reuters Tuesday that the government had not discussed with the Fund a plan to pay the IMF all of its $15 billion in debt ahead of schedule. Cabinet Chief Alberto Fernandez said last weekend the government was considering paying off the IMF debt in order to escape strict loan requirements on fiscal and economic reform.

Political News

Report Accuses Brazil's Former Bank Chief, Others of Financial Crimes

A Brazilian congressional report released Tuesday accuses 91 people, including former Central Bank President Gustavo Franco, of involvement in suspected money laundering, smuggling, and other crimes, Reuters reported. The report on the investigation into illegal overseas transfers of \$80-\$150 billion between 1996 and 2002 said Franco, who headed the Central Bank from 1997 to 1999 under ex-President Fernando Henrique Cardoso of the opposition PSDB party, established accounts that made it easier to transfer funds. Franco, who along with others named in the report is accused of tax evasion and other crimes, could face a criminal investigation by state prosecutors. The report's findings outraged opposition lawmakers, who questioned why current Central Bank President Henrique Meirelles—accused earlier this year of tax evasion—was not mentioned in the report. "I am shocked the report freed Meirelles, who is accused of irregularities, and accused Gustavo Franco," Senate PSDB leader Arthur Virgilio was quoted as saying.

Company News

Brazil's Bradesco to Finance Loans to Pensioners

Bradesco, Brazil's largest private bank, announced Tuesday a plan to provide 4 billion reais (\$1.4 billion) in credit to state pensioners through regional bank **Cruzeiro do Sul**. Bradesco will inject at least 100 million reais per month into Cruzeiro do Sul for the next three years, the bank said, Reuters reported Tuesday. "The opportunity arose to raise our liquidity through a partnership with Bradesco," said Adolpho Nardy, Cruzeiro do Sul's general director. "We will hand over to Bradesco all that generation of operations that is beyond our funding capacity." Earlier this week, Bradesco arranged a similar deal to provide 2 billion reais of credit to pensioners through another regional bank, **BMC**, over a period of three years. Brazilian banks have recently begun targeting niche creditors through the established networks of smaller financial institutions. Several banks, including **Banco Itau** and **Unibanco**, have teamed up with retailers.

Advisor Profile

OAS Secretary General Candidates

Editor's note: Three Latin Americans—former Salvadoran President Francisco Flores, Mexican Foreign Minister Luis Ernesto Derbez, and Chilean Interior Minister Jose Miguel Insulza—have emerged as the leading candidates to take over the helm of the Organization of American States following the resignation of Miguel Rodriguez in October. Below is some brief background information on each candidate.

Francisco Flores


Photo: UN.

At 39 years old, Francisco Flores became the youngest president in El Salvador's history in 1999. Flores, who ran unsuccessfully earlier this year against Rodriguez to succeed former Secretary General Cesar Gaviria, was nominated in November as the Central American candidate for the secretary general position. Since then, opponents of his candidacy, particularly in his own country, have alleged he was involved in corruption during his presidency. Flores has received the backing of the US, which provides about 60 percent of the OAS' budget, as he is the only candidate who fulfills the US government's two criteria of a Central American and a former president as the organization's next leader. He also has the support of Central American governments, except Honduras. The Venezuelan government opposes Flores because he was quick to recognize the interim government that briefly took power in a two-day coup against President Hugo Chavez in 2002.

Jose Miguel Insulza

On December 10, the Chilean government nominated Insulza, the current interior minister, as a candidate for OAS secretary general. Insulza, a socialist, had expressed interest in running for the Chilean presidency in 2005 as a candidate of the Concertacion coalition, but has decided to run for the OAS post instead. Insulza served as foreign minister from 1994 to 1999 and has since been the *de facto* Cabinet chief for President Ricardo Lagos. The Chilean media has reported that Insulza has likely obtained the support of the governments of Argentina, Brazil and possibly Venezuela for the OAS job, but some analysts say opposition to another South American head of OAS following the departure of Colombia's Cesar Gaviria earlier this year may be too strong to allow Insulza to win, particularly without the backing of the US.

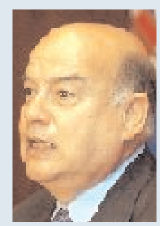
Photo: OAS.

Luis Ernesto Derbez


Photo: SRE.

Last week, Mexican President Vicente Fox nominated Derbez, his foreign minister, for the top OAS post. Mexico originally had said it would support a Central American candidate. Analysts speculate Fox named Derbez to free up the presidential candidacy of his ruling party (PAN) in 2006, for which Fox may have current Interior Minister Santiago Creel in mind. Derbez, a former World Bank economist, has worked on economic recovery programs in several countries, as a professor, and as an independent consultant for the Inter-American Development Bank. Derbez has said several factors favor his candidacy, including Mexico's positive relations with its neighbors in the Caribbean, Central America, the US and Canada. Derbez has the backing of Canada and some Caribbean countries.

Sources: The Tico Times, El Nacional, The Miami Herald, Mercopress, *COHA.*

Featured Q&A

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A **Guest Comment: Jan Dehn:** "We think the shift in control of Ecuador's courts has no immediate economic impact, but it is arguably the most important political development to date in the Gutierrez presidency. Control of Ecuadorean courts matters, because it confers upon the controller a credible and paralyzing threat to exile or imprison political opponents (it was this power which sent former President Gustavo Noboa into exile shortly after he left office and it is the same power which causes so much hesitation about external debt buybacks among officials). This power now appears to have moved the parties, which supported last week's action, notably the PRE and PRIAN parties, while the PSC's influence has diminished sharply. In the short term, this likely diminishes the threat to President Gutierrez's tenure. Longer term, the reshuffle at the Supreme Court may prove negative for political stability. The precedent that Congress can change the composition of the Supreme Court with a simple majority has now been established. All else even, this makes the court more sensitive to the balance of power in Congress. For Gutierrez, this is risky. We think last week's coalition was not so much a pro-Gutierrez coalition as an anti-large parties coalition, and support for Gutierrez could quickly evaporate. In other words, for Gutierrez today's friendly court could prove tomorrow's unfriendly court."

A **Guest Comment: Walter Spurrier:** "The previous court was appointed under the Constitution that was drawn a few years back. The court system was that the justices themselves would choose the successors to the justices that retired. There was the criticism that the largest party in Ecuador—the Social Christian party—had undue influence on that court. On the other hand, it was felt that as time went by, the political influence on the Supreme Court was going to weaken. What happened recently is that a new congressional majority proceeded to dispatch the previous justices and appoint new justices according to the political interests of the parties involved plus the government. In other words, they did not follow due process, and this is seen as further weakening institutionality by doing away with a system that was gradually improving the independence of the courts—although they were not totally independent—and creating a new Court which is absolutely composed of justices that owe their appointments to a group of politicians. In Ecuador, the position of the US government has been construed as favorable to Gutierrez. The reason for this is that, in a way, Gutierrez's alliance with Bucaram and Gustavo Noboa was a defensive move because the other parties wanted to get him out of the presidency pretty much the way it happened with Bucaram in 1997. The US government thought what was being done by the previous majority was preposterous, and so it has remained rather quiet after the recent events. The previous majority charges the US has tilted in favor of Gutierrez. I think the US government should insist on due process. The US government has stated through its ambassador that it cannot be a judge on whether the procedure followed to change the court was legitimate or not. But perhaps the US should insist on the principle that there should be a rule of law."

Andres Mejia-Acosta *is Killam Research Fellow in the Department of Political Science at the University of British Columbia.*

Jan Dehn *is an Analyst at Credit Suisse First Boston.*

Walter Spurrier *is Publisher and Editor of* Weekly Analysis *in Ecuador.*

Latin America Advisor
is published every business day by the Inter-American Dialogue, Copyright © 2004

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Latin America Advisor is published every business day by the Inter-American Dialogue
1211 Connecticut Avenue, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553